

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF SOUTH CAROLINA**

**REBUTTAL TESTIMONY OF  
ELLEN LAPSON  
ON BEHALF OF  
SOUTH CAROLINA ELECTRIC & GAS COMPANY  
DOCKET NO. 2017-370-E**

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## EXHIBITS

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| EL-2 | Moody's Investors Service, Credit Opinion, South Carolina Electric & Gas: Update Following Rating Confirmation, July 23, 2018 |
| EL-3 | Moody's Credit Scorecard  |
| EL-4 | Fitch Ratings, Press Release: Fitch Downgrades SCANA to 'BB'/SCE&G to 'BB+'; Maintains Rating Watch Evolving, August 8, 2018  |
| EL-5 | Fitch Ratings, South Carolina Electric & Gas Co., July 16, 2018   |
| EL-6 | Revising O'Donnell Table 1 and Exhibit KWO-1  |

1 I. INTRODUCTION

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is Ellen Lapson and my business address is 370 Riverside Drive,  
4 New York, New York 10025.

5 Q. ARE YOU THE SAME ELLEN LAPSON WHO HAS PREVIOUSLY FILED  
6 TESTIMONY IN THIS DOCKET?

7 A. Yes, I filed Direct Testimony on behalf of South Carolina Electric & Gas  
8 Company, referred to throughout my Rebuttal Testimony as “SCE&G” or the  
9 “Company.”

10 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

11 A. The purpose of my rebuttal testimony is to respond to the Direct Testimonies  
12 of Mr. Richard Baudino and Mr. Lane Kollen on behalf of the South Carolina Office  
13 of Regulatory Staff (“ORS”). I also respond to the Direct Testimonies of Mr. Ronald  
14 Binz and Mr. Uday Varadarajan on behalf of the South Carolina Coastal  
15 Conservation League (“CCL”) and the Southern Alliance for Clean Energy  
16 (“SACE”), to the Direct Testimony of Mr. Kevin O’Donnell on behalf of the South  
17 Carolina Energy Users Committee (“SCEUC”), and to the Direct Testimony of Mr.  
18 Scott Rubin on behalf of AARP.

## II. EXECUTIVE SUMMARY

**Q. PLEASE PROVIDE A SUMMARY OF YOUR REBUTTAL TESTIMONY.**

A. The testimony of witnesses Baudino and Kollen, as well as witnesses O'Donnell and Rubin, contain recommendations that, if adopted by the Commission, would severely reduce SCE&G's ongoing cash flow and consequently place the Company in a weakened financial condition. This outcome would be inconsistent with customers' need for electric service from a financially sound and capable utility that has sufficient liquidity to maintain its system in good order at all times and to be able to attract capital as needed to make new investments for safe and reliable service and to respond to emergencies like large scale outages from hurricanes or ice storms.

Because the opposing witnesses have failed to give meaningful consideration to the need to maintain SCE&G in a sound and sustainable financial condition, there is a need for a systematic analysis of the consequences of the major proposals on the Company's future financial health and creditworthiness. Consequently, I have performed an evaluation of the impact of the various financial adjustments and recommendations proposed by ORS ("ORS Plan") through a careful study of the most recently published comments by the three credit rating agencies concerning SCE&G's expected credit ratios and the sensitivities for positive and negative ratings changes. My study concludes that implementation of the ORS Plan would most likely produce credit ratings for SCE&G in the speculative grade category, and at least three to four notches below the median or average credit ratings for electric

1 utilities in the United States. By contrast, the financial outcome of the Customer  
2 Benefit Plan and No Merger Benefit Plan (as proposed by SCE&G and Dominion  
3 Energy and described in the testimony of Iris Griffin) is consistent with credit  
4 ratings within the investment grade category and stabilizing the Company's  
5 financial condition in a manner that would better position SCE&G to serve its  
6 customers' future needs.

7           Witnesses Kollen, Binz, and Varadarajan also assert that customer rates  
8 could be further reduced by securitizing the regulatory asset representing the costs  
9 of the abandoned nuclear project that are approved for rate recovery. However,  
10 deciding on a plan to securitize a regulatory asset is simply not an available option  
11 at the present time. In order to carry out such a transaction, special legislation would  
12 have to be passed that does not now exist. Even if such legislation was ultimately  
13 proposed and passed by the South Carolina General Assembly, however, there are  
14 some serious factors that could delay or rule out a securitization transaction,  
15 including: (1) whether or not such special legislation and the resulting special tariff  
16 to recover the securitized investment would withstand a voter ballot initiative or  
17 referendum in South Carolina; (2) the possibility that an appellate court may  
18 invalidate the decision that gives rise to the securitized regulatory asset; and (3)  
19 insufficient confidence by investors in whether state public officials could be trusted  
20 to abide by the terms of the securitization transaction for the full term of 20 years,  
21 given the legislature's abandonment of the BLRA, which it enacted in 2007.

1 Even if these issues are addressed, the required legislation passed, and  
2 securitization becomes a real possibility at some time in the future, it also would  
3 require a separate and distinct regulatory process to approve and implement the  
4 securitization transaction. Since none of the required conditions have been met or  
5 even proposed, it is entirely premature and inappropriate to contemplate, much less  
6 to make, financial decisions guided by the outline of a hypothetical securitization as  
7 a possible outcome of this proceeding.

8 **Q. HOW IS THE REMAINDER OF YOUR REBUTTAL TESTIMONY**  
9 **ORGANIZED?**

10 A. The remainder of my Rebuttal Testimony is organized as follows:

11 Section III – Response to the Direct Testimony of ORS Witness Richard  
12 Baudino;

13 Section IV – Response to the Direct Testimony of ORS Witness Lane Kollen;

14 Section V – Response to the Direct Testimony of SCEUC Witness Kevin  
15 O'Donnell;

16 Section VI – Response to the Direct Testimony of AARP Witness Scott  
17 Rubin;

18 Section VII – Issues Regarding Proposed Securitization Transaction; and

19 Section VIII – Conclusions.

1           **III.    RESPONSE TO THE DIRECT TESTIMONY OF MR. BAUDINO**

2   **Q.    PLEASE PROVIDE A BRIEF SUMMARY OF MR. BAUDINO’S DIRECT**  
3   **TESTIMONY AND RECOMMENDATION.**

4   A.           Mr. Baudino proposes making approval of the proposed business  
5               combination of SCE&G and Dominion Energy subject to conditions regarding  
6               service quality and “credit quality conditions,” including that the Commission  
7               should estimate a cost of capital for SCE&G based on the assumption that the  
8               Company’s credit is of strong investment grade quality, even if that is not the case.  
9               Such a recommendation ignores how capital markets function and its adoption  
10              would make capital more expensive for SCE&G

11             In addition, Mr. Baudino recommends that the Commission apply a return  
12             on equity (“ROE”) of 9.1% to the portion of New Nuclear Development (“NND”) costs that ORS proposes should be allowed for rate recovery. Mr. Baudino arrives  
13             at his 9.1% ROE recommendation based on a Discounted Cash Flow (“DCF”) study  
14             of investment grade rated utility companies that are not of comparable risk to  
15             SCE&G, without any ROE risk premium for SCE&G’s current financial condition.  
16             He also endorses ORS’s capital structure recommendation of 52.81% equity to total  
17             capital as September 30, 2017. Finally, he recommends modifying the cost of  
18             SCE&G’s long-term debt to incorporate the cost of debt issued by the Company in  
19             August 2018.

21   **Q.    MR. BAUDINO STATES THAT THE ALLOWED ROE IN THIS**  
22   **PROCEEDING SHOULD BE BASED ON THE REQUIRED ROE FOR**

**FINANCIALLY SOUND REGULATED UTILITY COMPANIES AND NOT  
A HIGHER ROE BASED ON SCE&G'S CURRENT CREDIT RATINGS.<sup>1</sup>  
HOW DO YOU RESPOND?**

A. This is not a reasonable proposal. A company's risk is an important determinant of the cost of capital for that company, and therefore, the cost of equity must be determined by comparison with companies of comparable risk. For SCE&G, it is inevitable that any reasonable proxy group will primarily consist of less risky and more highly-rated companies, since there are currently few if any utilities in the United States of comparably low ratings as SCE&G. Under these circumstances, the equity return determined based upon the less risky proxy group should be supplemented to reflect the greater financial risk. Failing to do so would deprive SCE&G of the opportunity to attract needed capital, because limited capital resources will be invested elsewhere to earn the same return at lower risk.

**Q. PLEASE RESPOND TO MR. BAUDINO'S TESTIMONY REGARDING  
THE REPORT ISSUED BY S&P AND THE UNCERTAINTY REGARDING  
THE RECOVERY OF COSTS RELATED TO THE NUCLEAR PROJECT?<sup>2</sup>**

A. It appears that Mr. Baudino seriously misunderstands and misconstrues the meaning of the credit rating agencies' reports. He incorrectly interprets that credit downgrades and negative rating outlooks or credit watch status by Moody's and

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<sup>1</sup> Baudino Direct at 15-16.

<sup>2</sup> Baudino Direct at 16-17.

1 S&P are a product of “uncertainty” regarding the rate treatment of the nuclear  
2 project at the V.C. Summer Nuclear Station (“Project”) and future revenues that  
3 would be remedied by the certainty provided by implementing the ORS Plan.  
4 Instead, the clear meaning of the rating analysts expressed in their reports is their  
5 concern that SCE&G will be subjected to a major permanent disallowance of  
6 recovery of its investment in the Project assets.

7 Mr. Baudino also asserts that the ORS Plan will create greater certainty  
8 which will cure the Company’s credit problems. His assertion is not credible,  
9 however. Implementing the ORS Plan will not strengthen or improve the credit  
10 standing of SCE&G. In fact, the very same rating reports that Mr. Baudino  
11 mischaracterizes state that reduced cash flow and weaker financial ratios after  
12 implementing a plan as punitive as that proposed by ORS would result in credit  
13 downgrades.

14 For example, the S&P July 3, 2018 Research Update, cited by Mr. Baudino,  
15 makes it quite clear that their concern is focused on a rate decrease and weaker  
16 financial measures, and the certainty of high leverage and poor financial ratios will  
17 not improve SCE&G’s financial strength:

18 We could lower the ratings if the Court does not issue an injunction  
19 prohibiting the SCPSC from implementing the new law [House Bill  
20 4375]. A rate decrease of the magnitude reflected in the law would  
21 weaken credit metrics significantly. We could also lower ratings even  
22 if the Court issues an injunction that is subsequently followed by a  
23 SCPSC order to reduce rates or an order to provide rate credits for

1 Summer-related costs that results in weaker financial measures.<sup>3</sup>

2  
3 In a subsequent Research Update on August 9, 2018 (in which S&P announced that  
4 it had downgraded SCANA and SCE&G and that the ratings remained on credit  
5 watch with negative implications), S&P again uses the word “uncertainty” but the  
6 text explicitly states that further reduction in revenues and cash flows could result  
7 in a further downgrade of the credit rating.

8 The CreditWatch with negative implications on SCANA and its  
9 subsidiaries reflects our view of ongoing uncertainty regarding cost  
10 recovery of the abandoned V.C. Summer nuclear construction project.  
11 We could lower ratings again if credit metrics weaken further beyond  
12 those in our base-case scenario, which assumes the temporary rate cut  
13 is made permanent. This could occur following the pending Summer  
14 abandonment proceeding if the PSC orders a permanent rate reduction  
15 or rate credits that lead to incrementally weaker financial measures  
16 than those resulting from the temporary 15% rate cut.<sup>4</sup>

17  
18 **Q. MR. BAUDINO SEEKS TO DISMISS CONCERNS ABOUT THE**  
19 **COMPANY’S VERY LOW CREDIT RATINGS, STATING THAT SCE&G**  
20 **HAS BEEN ABLE TO ACCESS THE CAPITAL MARKETS THIS YEAR**  
21 **AND ON FAVORABLE TERMS.<sup>5</sup> DO YOU AGREE?**

22 **A.** Mr. Baudino acknowledges that SCE&G’s ratings are currently very low  
23 (Baudino Direct at 4:7-8 and at 16:1-2), but he seeks to minimize the significance

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<sup>3</sup> S&P Research Update, SCANA Corp. And Subsidiaries 'BBB' Ratings Remain On CreditWatch Negative On Passage Of South Carolina Bill, July 3, 2018, at 3.

<sup>4</sup> S&P Research Update, SCANA Corp. And Subsidiaries Downgraded To 'BBB-' After Court Rejects Company's Request; CreditWatch Negative Maintained, August 9, 2018, at 3.

<sup>5</sup> Baudino Direct at 18.

1 of the Company's low issuer credit ratings by pointing out that the Company  
2 successfully completed the offering of first mortgage bonds in August 2018.

3 Here, Mr. Baudino makes a faulty and misleading comparison between the  
4 pricing and coupon for the 10-year issuance with the August 2018 yield on what he  
5 asserts to be the yield on the average utility bond in the same month. Mr. Baudino  
6 asserts:

7 The pricing and coupon for the 10-year 4.25% first mortgage issuance  
8 is consistent with the August 2018 yield on the average utility bond,  
9 which was 4.33%.<sup>6</sup>...Based on this information, it appears that  
10 SCE&G is well able to access the debt market at reasonable rates.<sup>7</sup>

11 First, it is important to note that SCE&G's bond issuance took place on  
12 August 15, 2018—six weeks before ORS filed its direct testimony in this  
13 proceeding. Therefore, the ability to issue these bonds does not provide evidence  
14 that investors are comfortable with the impacts of the ORS Plan or would make  
15 capital available on similar terms in the future, if the ORS Plan were adopted by the  
16 Commission.

17 Also, Mr. Baudino fails to note that SCE&G's issuance was split between  
18 \$300 million of 3-year maturity bonds and \$400 million of 10-year maturity bonds,  
19 for a blended average maturity profile of seven years. This represents a short  
20 maturity profile in the electric utility sector, with the typical issuance pattern of  
21 bonds issued by rate-regulated utility operating companies comprised of 30-year or

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<sup>6</sup> Although Mr. Baudino does not cite the basis for the referenced yield on the "average utility bond," an examination of his exhibits and work papers indicates that his source is the Mergent Bond Record.

<sup>7</sup> Baudino Direct at 18:17-20.

1 even 40-year maturities mixed with some 10-year maturities. In fact, the “average”  
2 utility operating company mortgage bond is a 30-year bond.

3 **Q. PLEASE EXPLAIN THE SIGNIFICANCE OF THE RELATIVELY SHORT**  
4 **TENOR OF THE COMPANY’S BOND ISSUANCE IN AUGUST 2018.**

5 A. The issuance of bonds with relatively short maturities of 3 and 10 years  
6 indicate that bond underwriters and utility bond investors are uneasy about  
7 SCE&G’s future creditworthiness and credit ratings, meaning there was insufficient  
8 demand at reasonable rates for bonds with the longer tenor of 30 years, which is the  
9 more typical bond maturity issued by investment-grade rate-regulated utility  
10 operating companies.

11 **Q. DO YOU AGREE WITH THE WAY THAT MR. BAUDINO INTERPRETS**  
12 **THE INTEREST COST OF SCE&G’S AUGUST 2018 BOND ISSUANCE**  
13 **RELATIVE TO THE “AVERAGE” UTILITY BOND ISSUANCE IN**  
14 **AUGUST?<sup>8</sup>**

15 A. No, I do not. Mr. Baudino erroneously compares the interest cost of 4.25%  
16 on SCE&G’s 10-year issue with the rate of 4.33% reported by Mergent Bond  
17 Record for the “average” utility bond. However, Mergent’s “average” rate reflects  
18 bonds of longer terms, including a high proportion of 30-year bond issues. A more  
19 meaningful comparison would be the contemporary yield on new issue investment-  
20 grade 10-year mortgage bonds of rate-regulated electric utilities.

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<sup>8</sup> Baudino Direct at 18:17-20.

For an appropriate comparison, we compared SCE&G's cost to issue bonds in August 2018 on the only four secured, 10-year bond issued in August 2018 by electric operating utilities. These were issued by Duke Energy Progress LLC ("Duke Progress"), Oncor Electric Delivery Company LLC ("Oncor"), Commonwealth Edison Company ("ComEd"), and Oklahoma Gas and Electric Company ("OG&E") within approximately a week of the date of SCE&G's two issues.

**Table EL-1**

**August 2018 10-Year Secured Bond Issues by  
Rate-Regulated Electric Utilities**

| Issuer                        | Issue Date | Years | Coupon | Amt. \$ million | Spread to UST* | Premium Charged to SCE&G* | <u>Secured bond ratings</u> |      |       |
|-------------------------------|------------|-------|--------|-----------------|----------------|---------------------------|-----------------------------|------|-------|
|                               |            |       |        |                 |                |                           | Moody's                     | S&P  | Fitch |
| South Carolina Electric & Gas | 8/15/18    | 10    | 4.25%  | \$400           | 143            |                           | Baa1                        | BBB+ | BBB   |
| Duke Energy Progress LLC      | 8/6/18     | 10    | 3.70%  | \$500           | 77             | +66                       | Aa3                         | A    | --    |
| Oncor Electric Delivery LLC   | 8/7/18     | 10    | 3.70%  | \$350           | 73             | +70                       | A2                          | A+   | A     |
| Commonwealth Edison Co.       | 8/7/18     | 10    | 3.70%  | \$550           | 75             | +68                       | A1                          | A-   | A     |
| Oklahoma Gas and Electric     | 8/14/18    | 10    | 3.80%  | \$400           | 93             | +50                       | A2                          | BBB+ | A     |
| Average Differential          |            |       |        |                 |                | +63.5                     |                             |      |       |

\* Spread to the yield on 10-year US Treasury notes on the date of issue, in basis points, i.e., 1/100 of 1%

Source: CiBC Debt Capital Markets, "US Utilities Weekly for the week ending August 31, 2018".

The table above compares the credit spreads on each bond issue relative to the 10-year U.S. Treasury bond yield on the same date. SCE&G had to pay a spread to U.S. Treasuries of 143 basis points. That yield spread was 66 to 70 basis points

1 greater than the yield required by the market for issuance of 10-year secured  
2 mortgage bonds by Duke Progress, Oncor, and ComEd and 50 basis points greater  
3 than the required yield for secured bonds of OG&E. The credit quality these four  
4 utilities is consistent with that of the “average utility,” which is approximately three  
5 notches higher than SCE&G’s current rating. This difference clearly reflects that  
6 the investment community requires higher compensation to accept the greater risk  
7 that they perceive in SCE&G, thus resulting in additional financing costs to the  
8 Company and its customers. Furthermore, the differential cost of financing for  
9 SCE&G relative to the “average utility” would likely be greater if the final outcome  
10 of this proceeding results in a revenue reduction equivalent to that in the ORS Plan.

11 **Q. DOES MR. BAUDINO PROVIDE EVIDENCE REGARDING SCE&G’S**  
12 **FUTURE FINANCIAL CONDITION IN THE EVENT THAT THE ORS**  
13 **PLAN IS IMPLEMENTED?**

14 A. No, he does not, other than the assertion that SCE&G was able to sell  
15 collateralized first mortgage bonds in August 2018, which I have discussed above.  
16 Of course, the ability to issue secured mortgage bonds in August 2018, albeit at  
17 yield spreads higher than those paid by utilities with higher ratings, completely  
18 ignores the future effects upon the Company’s financial integrity or  
19 creditworthiness in the event that the ORS Plan is implemented.

20 Further, Mr. Baudino does not acknowledge that SCE&G has already  
21 experienced constrained access to the commercial paper market to fund short-term  
22 needs. Investors buy smaller amounts of SCE&G’s notes at the current ratings, and

1       only make funds available at higher cost and for very few days. Access to the  
2       commercial paper market would be completely eliminated if SCE&G's credit  
3       ratings were further reduced.

4               Furthermore, Mr. Baudino fails to address the difficulties that SCE&G would  
5       face with credit ratings substantially below the norm for the United States utility  
6       industry during any future period of credit market distress or constrained capital  
7       market conditions. The median issuer credit ratings for electric utility operating  
8       companies is A- (by S&P and Fitch) and A3 by Moody's, versus SCE&G's current  
9       issuer credit rating of BBB- (S&P), Baa3 (Moody's) and BB+ (Fitch). SCE&G's  
10      ratings by Moody's and S&P are three rating notches below the median for rate-  
11      regulated electric utilities and its Fitch rating is four notches below the sector  
12      median. The experience from past market cycles indicates that during any future  
13      period capital market or credit market distress, credit ratings materially below the  
14      norm for the sector (and potentially even lower in the event of another round of  
15      downgrades for SCE&G depending on the outcome of this proceeding), would  
16      seriously constrain SCE&G's access to capital and sources of liquidity.

17   **Q.   HOW DO YOU RESPOND TO MR. BAUDINO'S TESTIMONY THAT**  
18   **SCE&G SHOULD BE REQUIRED TO INCLUDE ITS TWO NEW DEBT**  
19   **ISSUANCES IN ITS COST OF LONG-TERM DEBT?**<sup>9</sup>

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<sup>9</sup> Baudino Direct at 36: 3-9.

1 A. It is not reasonable to make such an adjustment to long-term debt costs after  
2 the end of the test period. This change would immediately reduce SCE&G's cash  
3 flow, while also delaying or deferring many other changes that would aid SCE&G's  
4 cash flow recovery of cost until the conclusion of its next base rate case.

5 ORS's position as explained in Mr. Kollen's Direct Testimony is that the  
6 Company should be directed to defer recovery of the transmission revenue  
7 requirement and associated non-nuclear investments made by SCE&G subsequent  
8 to its last base rate case for consideration in the next base rate case. It is neither  
9 reasonable nor equitable to recognize a change in interest expense relating to bonds  
10 redeemed after the test period while deferring the recovery of and return on a  
11 substantial investment in non-nuclear assets.

12 **Q. DO YOU AGREE WITH MR. BAUDINO'S RECOMMENDATION THAT,**  
13 **AS A CONDITION OF THE BUSINESS COMBINATION, THE ROE**  
14 **SHOULD BE DETERMINED USING A PROXY GROUP OF INVESTMENT**  
15 **GRADE UTILITIES AND THE COST OF NEW LONG-TERM DEBT**  
16 **SHOULD BE BASED ON THE LOWER OF THE PREVAILING COST OF**  
17 **DEBT FOR AN AVERAGE INVESTMENT GRADE REGULATED**  
18 **UTILITY?**<sup>10</sup>

19 A. I disagree. It is not reasonable to determine the cost of equity for SCE&G  
20 based upon the cost determined for a group of companies of materially lower risk.

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<sup>10</sup> Baudino Direct at 62-64.

1 The cost of equity for SCE&G should be determined by comparison with companies  
2 of comparable risk. If there are not a sufficient number of like utilities of risk  
3 comparable to that of SCE&G to comprise an adequate peer group, as would be the  
4 case in the current proceeding, then the cost of equity determined for the lower risk  
5 peer group should be supplemented to reflect SCE&G's higher risk. The logic is  
6 clear. If an investor can get the same return by investing in a portfolio of companies  
7 of lower risk than SCE&G, it would be illogical to invest any capital whatsoever in  
8 SCE&G at much greater risk.

9 Likewise, the cost of debt used in the future for determining rates should be  
10 consistent with the actual cost of issuing debt, which will be increased by the weak  
11 credit condition imposed on the Company under the ORS Plan.

12 **IV. RESPONSE TO THE DIRECT TESTIMONY OF MR. KOLLEN**

13 **Q. PLEASE PROVIDE A BRIEF SUMMARY OF MR. KOLLEN'S DIRECT**  
14 **TESTIMONY AND RECOMMENDATION.**

15 A. Mr. Kollen recommends a revenue reduction of \$560 million for 2019 and  
16 \$527 million for 2020. In comparison with the Experimental Rate currently in effect,  
17 the proposed 2019 reduction is \$193 million greater, and for 2020 \$160 million  
18 greater. Those figures include a \$35 million revenue reduction in 2019 and \$70  
19 million in 2020 applicable only if the business combination is consummated.

20 Components in the ORS Plan include: (1) termination of the \$445 million  
21 annually recovered in rates consistent with the Base Load Review Act ("BLRA"),  
22 partially offset by a revenue requirement of \$86.2 million in 2019 for the levelized

1 recovery of and return on a net regulatory asset (net of regulatory liabilities) for an  
2 allowed portion of the nuclear abandonment cost;<sup>11</sup> (2) a reduction of \$98.7 million  
3 in each year relating to a Capital Cost Recovery (“CCR”) Rider reduction for Tax  
4 Cut and Jobs Act (“TCJA”); and (3) a one-time refund in 2019 of \$68.2 million for  
5 TCJA Regulatory Liability.

6 Mr. Kollen also recommends that the Commission order the Company to  
7 defer the BLRA transmission revenue requirement (accruing a long-term debt rate  
8 of return on the deferred amounts), pending a future base rate proceeding. As I  
9 discuss further in Section VII of my testimony, he also recommends that the  
10 Company sell its rights to collect a special tariff in a transaction funded with secured  
11 debt (“Securitization Transaction”) in order to fund at a lower cost the net regulatory  
12 asset (net of regulatory liabilities) for the allowed portion of nuclear abandonment  
13 costs. Finally, he presents a list of business combination conditions and  
14 commitments.

15 **Q. DO YOU AGREE WITH MR. KOLLEN’S RECOMMENDATION THAT**  
16 **SCE&G DEFER A RATE OF RETURN USING THE COST OF LONG-**  
17 **TERM DEBT, DEPRECIATION, INCREMENTAL OPERATION AND**  
18 **MAINTENANCE (“O&M”) EXPENSES, OTHER INCREMENTAL TAXES**  
19 **EXPENSES (PAYROLL AND PROPERTY TAX EXPENSES), AND OTHER**

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<sup>11</sup> Mr. Kollen recommends that the costs to be recovered through a new Capital Cost Recovery Rider be the allowed abandonment costs incurred through March 12, 2015, less related regulatory liabilities and a return on these costs, net of the related liability ADIT and asset NOL ADIT.

1       **INCREMENTAL OPERATING EXPENSES, E.G., INSURANCE EXPENSE,**  
2       **UNTIL THE EFFECTIVE DATE WHEN RATES ARE RESET TO**  
3       **INCLUDE THE ALLOWED AMOUNT OF THESE COSTS IN A FUTURE**  
4       **BASE RATE PROCEEDING?<sup>12</sup>**

5     A.       No, I do not agree. This proposal will result in severe regulatory lag and will  
6       further weaken cash flows that would already be greatly weakened by the other  
7       aspects of the ORS Plan. Mr. Kollen's recommendation to further deprive SCE&G  
8       of recovery of investment that is in-service and defer the recovery of other costs and  
9       expenses for several years while recommending that the Company flow through  
10       immediately all benefits of the TCJA is unjust and inequitable and would deprive  
11       SCE&G of needed cash flow.

12     **IV.A Implications of Proposals for SCE&G's Future Financial Strength**

13     **Q.   DOES MR. KOLLEN PROVIDE ANY TESTIMONY REGARDING**  
14       **SCE&G'S       FUTURE       FINANCIAL       CONDITION       AND**  
15       **CREDITWORTHINESS   IN   THE   EVENT   THAT   HIS**  
16       **RECOMMENDATIONS ARE IMPLEMENTED?**

17     A.       No, I do not find any evidence in Mr. Kollen's testimony regarding the  
18       outlook for SCE&G's creditworthiness or access to capital if the Commission  
19       adopts the ORS Plan, nor any comparison with the Company's future  
20       creditworthiness pursuant to the SCE&G proposals. In sum, he recommends the

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<sup>12</sup> Kollen Direct at 11.

1           ORS Plan without regard or consideration for the financial harm it would cause to  
2           SCE&G and its utility operations in the future.

3   **Q.   IS THERE A SOUND BASIS FOR PREDICTING THE RESPONSES OF**  
4           **CREDIT RATING AGENCIES IN THE EVENT THAT THE COMMISSION**  
5           **ADOPTS THE ORS PLAN?**

6   A.           Yes. The three credit rating agencies have published commentaries on the  
7           credit guidelines that they apply when rating SCE&G, and they have given  
8           indications of their likely rating rationales upon the conclusion of this proceeding.  
9           The rating agencies strive to make their expectations for each company they rate  
10          clear to the investing public. Interpreting the rating agencies' most recently  
11          published comments and each agency's financial ratio benchmarks provides a  
12          reasonable outline of the credit rating actions that would result from the imposition  
13          of the ORS Plan. Since each agency has different rating criteria and financial ratio  
14          guidelines, I review the credit agencies one at a time and begin with S&P.

15   **Q.   PLEASE EXPLAIN YOUR VIEW OF THE LIKELY IMPACT ON S&P'S**  
16           **RATING OF SCE&G IF THE COMMISSION ADOPTS THE ORS PLAN.**

17   A.           S&P's current credit rating of SCE&G was downgraded to BBB- (the lowest  
18           rating within the investment grade category) on July 3, 2018, and the rating is on  
19           Credit Watch with negative implications. S&P states very clearly in its report  
20           published August 23, 2018:

21                   We could lower ratings again if credit metrics weaken further beyond  
22                   those in our base-case scenario, in which we assume the temporary  
23                   rate cut is permanent. This could occur following the pending Summer

1           abandonment proceeding if the PSC orders a permanent rate reduction  
2           or rate credits that lead to incrementally weaker financial measures  
3           than those resulting from the temporary 15% rate cut. Conversely, we  
4           could affirm ratings if the PSC does not require further rate credits or  
5           rate reductions beyond the 15% rate reduction already assumed in our  
6           base-case scenario.<sup>13</sup>

7           The S&P report predicts that if the outcome of this case is equivalent to the 15%  
8           revenue reduction effective under the Experimental Rate, the Company's core  
9           financial ratios will weaken.<sup>14</sup> S&P forecasts that the ratio of FFO-to-Debt will  
10          decline to 14%, while the ratio of Debt-to-EBITDA will increase to the range of 4.5  
11          to 5.5 times. These numbers are meaningful, because S&P's predicted FFO-to-Debt  
12          ratio of 14% is very close to the borderline of 13% between Significant Financial  
13          Risk and Aggressive Financial Risk; the predicted Debt-to-EBITDA ratio of 4.5 to  
14          5.5 times is consistent with Aggressive Financial Risk. Consequently, if the revenue  
15          reduction is limited to 15% or less, SCE&G's predicted core leverage ratios would  
16          hover near the borderline between financial risk assessments of Significant and  
17          Aggressive, with one ratio just above the border and one below. That would imply  
18          a rating of either BBB- or BB+.

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<sup>13</sup> Standard & Poor's Ratings Direct, Summary, South Carolina Electric & Gas, August 23, 2018, at 2. (Exhibit No. \_\_\_\_ (EL- 1)).

<sup>14</sup> S&P's two most important financial ratios are: Funds From Operation ("FFO") to Debt; and Debt to Earnings Before Interest, Income Tax, Depreciation and Amortization ("EBITDA"). A decline in FFO-to-Debt indicates higher debt leverage and greater financial risk. An increase in Debt-to-EBITDA is another indicator of higher debt leverage and greater financial risk. S&P refers to these two financial ratios as its "core" ratios.

1           However, the ORS Plan targets a revenue reduction of 20%, a steeper  
2           reduction than the 15% revenue reduction modeled by S&P. The implication is that  
3           FFO-to-Debt will fall below 13% and Debt-to-EBITDA will certainly be greater  
4           than 4.5 times, signifying that both core ratios will be in the Aggressive category  
5           under the ORS Plan. If S&P maintains its current business risk assessment of  
6           “Strong,” the predicted credit rating would be BB+. If S&P determines at the same  
7           time that an unfavorable regulatory environment for the Company warrants  
8           lowering its business risk assessment from “Strong” to “Satisfactory,” the resulting  
9           credit rating combining Aggressive financial risk with Satisfactory business risk  
10          would be BB. These results can be tracked on the grid that appears on page 6 of the  
11          report. Thus, my analysis leads me to conclude that if the Commission adopts the  
12          ORS Plan and the Dominion Energy business combination plan terminates, S&P  
13          would lower the SCE&G’s issuer credit rating to BB+ or possibly BB.

14   **Q.   WHAT WOULD BE THE LIKELY S&P CREDIT RATING OF SCE&G IF**  
15   **THE COMMISSION APPROVES THE CUSTOMER BENEFIT PLAN AND**  
16   **THE BUSINESS COMBINATION WITH DOMINION ENERGY?**

17   A.       The August 23, 2018 S&P report contains no comment about the Dominion  
18   Energy business combination, but based on S&P’s well-established consolidated  
19   rating methodology, it is certain that the resulting issuer credit rating of SCE&G  
20   would be equalized with the issuer credit rating of Dominion Energy at the time of  
21   the business combination. Currently Dominion Energy’s issuer credit rating is  
22   BBB+ with a negative outlook. S&P may lower Dominion Energy’s rating to BBB

1 to reflect the consolidation of SCE&G with Dominion Energy. In that case,  
 2 SCE&G's issuer credit rating would be upgraded by one notch from the current  
 3 BBB- to BBB; if S&P retains Dominion Energy's BBB+ rating, SCE&G's issuer  
 4 credit rating would rise by two notches to BBB+.

5 **Q. NOW LET'S TURN TO MOODY'S. WHAT IS YOUR VIEW OF THE**  
 6 **LIKELY IMPACT ON MOODY'S RATING OF SCE&G IF THE**  
 7 **COMMISSION ADOPTS THE ORS PLAN?**

8 A. Moody's rating of SCE&G is currently Baa3 (the lowest rating within the  
 9 investment grade category), with a negative rating outlook. The most recent  
 10 commentary published by Moody's was a Credit Opinion that appeared on July 23,  
 11 2018. In that report, Moody's commented on its negative outlook as follows:

12 The rating outlook is negative, reflecting the contentious political and  
 13 regulatory environment in which the company is operating. The  
 14 ratings could move downward if there is a further deterioration of the  
 15 legislative and regulatory compact, or if the impact on SCE&G's  
 16 credit profile is more severe than we anticipate. For example if we  
 17 expect the utility would not be able to maintain a ratio of CFO pre-  
 18 WC to debt that is at least around 13%.<sup>15</sup>

19  
 20 Also, Moody's states that it expects that the Commission will not impose a rate  
 21 reduction on SCE&G that is any greater than the 14.8% revenue reduction under the  
 22 Experimental Rate.<sup>16</sup> In the same report, Moody's forecasts that with a revenue  
 23 reduction of approximately 14.8%, SCE&G's ratio of Cash Flow from Operation

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<sup>15</sup> Moody's Investors Service, Credit Opinion, South Carolina Electric & Gas: Update Following Rating Confirmation, July 23, 2018, at 3. (Exhibit No. \_\_\_\_ (EL-2))

<sup>16</sup> S&P rounds the percentage to 15%; Moody's and Fitch cite a reduction of 14.8% for the Experimental Rate.

1 excluding Changes in Working Capital (“CFO pre-WC”) to Debt would weaken “to  
2 the mid-teens” but would be consistent with the current rating of Baa3. However,  
3 Moody’s states that if that ratio falls below 13%, the rating would be downgraded  
4 to Ba1 (a speculative grade rating). Therefore, I conclude that if the Commission  
5 adopts the ORS Plan and a revenue reduction of 20%, the resulting ratio of CFO  
6 pre-WC to Debt would decline to 13% or lower. Based on this erosion of the key  
7 leverage metric, Moody’s would be inclined to downgrade the issuer rating to Ba1,  
8 a rating decision that would be further supported if Moody’s deems that the  
9 Commission’s decision to impose such a severe rate reduction indicates an  
10 inequitable regulatory and political environment.

11 When evaluating the credit of a rate-regulated utility, Moody’s methodology  
12 bases 50% of the rating on a qualitative assessment of the regulatory environment  
13 and ability to recover costs and investments and 40% on the financial credit metrics;  
14 the remaining 10% of the rating is based on Moody’s assessment of the company’s  
15 diversification of risks. The regulatory factors that Moody’s analysts assess along  
16 with Moody’s current assessments of those factors relating to SCE&G appear in  
17 Exhibit No. \_\_\_\_ (EL-3).

18 Moody’s currently assesses SCE&G’s regulatory environment to be midway  
19 between the Baa and the Ba levels. Similarly, SCE&G’s score for the diversification  
20 factor is midway between Baa and Ba. Adoption of the ORS Plan would erode the  
21 scores for Financial Strength, and the combination of weaker financial metrics that  
22 fall short of the Baa category along with current scores for regulatory factors and

1 diversification factors straddling Baa and Ba categories would justify a credit rating  
2 reduction to the sub-investment grade rating of Ba1.

3 **Q. WHAT RATINGS ACTION WOULD MOODY'S TAKE IF THE**  
4 **COMMISSION APPROVES THE CUSTOMER BENEFIT PLAN AND THE**  
5 **BUSINESS COMBINATION WITH DOMINION ENERGY?**

6 A. Unlike S&P, Moody's issuer rating of SCE&G would not necessarily be  
7 identical with Moody's Baa2 issuer rating of Dominion Energy. Moody's rating of  
8 SCE&G as a subsidiary of Dominion Energy would reflect the standalone credit  
9 profile of the Company, but would also take into consideration the benefit of the  
10 combination with a larger and financially capable parent company. In the July 23,  
11 2018 Credit Opinion, Moody's states with regards to factors that could lead to an  
12 upgrade:

13 The rating outlook is negative; as such, the ratings are not likely to  
14 move upward over the next 12-18 months. The outlook could be  
15 returned to stable if the open docket at the SCPSC results in a rate plan  
16 that will support stable and predictable cash flow metrics, including a  
17 ratio of CFO pre-WC to debt of at least 13%. Completion of the  
18 proposed merger with Dominion Energy could also cause the outlook  
19 to be revised to stable.<sup>17</sup>  
20

21 I interpret that as very strong guidance that the approval of the Customer Benefit  
22 Plan and the business combination with Dominion Energy would lead Moody's to  
23 affirm the current rating of Baa3 and change the rating outlook to Stable.

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<sup>17</sup> Ibid. at 3.

**Q. WHAT IS YOUR ANALYSIS OF THE LIKELY IMPACT ON FITCH'S RATING OF SCE&G IF THE COMMISSION DECIDES TO ADOPT THE ORS PLAN?**

A. Fitch published its most recent comment on SCE&G on August 8, 2018 when it downgraded SCE&G's issuer rating to BB+ (a speculative grade rating) from BBB-. Fitch currently has the lowest rating of SCE&G, and the rating is on an Evolving Watch status, which indicates that the rating could either be upgraded or downgraded depending on the Commission's decision in the pending regulatory dockets. The August 8 press release commented on the imposition of the Experimental Rate, a revenue reduction it cited as approximately 14.8%. The release refers to the prospects for both SCE&G and SCANA ("SCG"), as follows:

Fitch considers the magnitude of the cut to be detrimental to SCE&G's and SCG's credit metrics, even after consideration of SCG's 80% reduction of the common dividend. Despite the legislature's characterization of the new rate as "temporary," Fitch is concerned that the expected December order could be of the same magnitude. If the PSC issues an order in December 2018 with a permanent cut of a similar magnitude, additional downgrades may be warranted. If the 14.8% rate cut were to be permanent, Fitch expects SCG's Total Adjusted Debt/EBITDAR to average around 6x over the next three years and SCE&G's to average around 5.7x, both above Fitch's previously stated downgrade thresholds of 5.5x and 5.0x, respectively.<sup>18</sup>

Adjusted Debt to Earnings before Interest, Income Tax, Depreciation and Amortization and Rent ("EBITDAR") is Fitch's key financial measure. A greater

<sup>18</sup> Fitch Ratings, Press Release: Fitch Downgrades SCANA to 'BB'/SCE&G to 'BB+'; Maintains Rating Watch Evolving, August 8, 2018, at 1 (Exhibit No. \_\_\_ (EL- 4)). *See also* Fitch Ratings, South Carolina Electric & Gas Co., July 16, 2018 (Exhibit No. \_\_\_(EL-5)).

1 ratio of Adjusted Debt to EBITDAR signifies higher debt leverage and greater  
2 financial risk. If a 14.8% revenue reduction would cause SCE&G's debt leverage to  
3 exceed Fitch's guidelines for the current rating of BB+, then the 20% revenue  
4 reduction pursuant to the ORS Plan would violate Fitch's guideline ratio by an even  
5 greater extent. Thus, implementation of the ORS Plan would likely lead to a further  
6 ratings downgrade for SCE&G to BB from BB+.

7 **Q. WHAT ACTION DO YOU EXPECT THAT FITCH WOULD TAKE IF THE**  
8 **COMMISSION APPROVES THE CUSTOMER BENEFIT PLAN AND THE**  
9 **BUSINESS COMBINATION WITH DOMINION ENERGY?**

10 A. Fitch stated in the August 8, 2018, press release:

11 Developments that May, Individually or Collectively, Lead to  
12 Positive Rating Action. The ratings could be upgraded if the merger  
13 into DEI and resolution of new nuclear issues result in SCE&G's  
14 adjusted debt/EBITDAR stabilizing around 3.5x-4.0x.<sup>19</sup>

15 That is consistent with the Evolving Watch that Fitch has maintained for SCE&G  
16 since the Company announced a business combination agreement with Dominion  
17 Energy. That watch status signals that either a downgrade or upgrade could occur  
18 depending on a binary outcome. It appears likely that the business combination with  
19 Dominion Energy in the context of the Customer Benefit Plan or a variant thereof  
20 would lead Fitch to upgrade SCE&G's issuer rating to BBB-.

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<sup>19</sup> Ibid. at 2.

**Q. PLEASE SUMMARIZE THE RESULTS OF YOUR REVIEW OF THE RESULTING CREDIT RATINGS IF THE COMMISSION ADOPTS A DECISION SIMILAR TO THE ORS PLAN, OR ON THE OTHER HAND, IF THE COMMISSION APPROVES THE BUSINESS COMBINATION AND ADOPTS THE CUSTOMER BENEFIT PLAN.**

A. I summarized the rating outcomes that were explained above in Table EL-2. The rationales explained in the rating agencies' most recent reports leads me to expect that the business combination with Dominion Energy and a plan equivalent to the Customer Benefit Plan, if approved, would result in the restoration or retention of low investment grade ratings by all three agencies, while a plan equivalent to the ORS Plan, if approved, would lead to sub-investment grade ratings in the BB/Ba category at all three agencies.

**Table EL-2**

**Predicted Credit Rating Impacts**

|         | Current<br>Issuer Credit<br>Rating | Current<br>Outlook       | Outcome<br>Equivalent to ORS<br>Plan | Approval of<br>Business<br>combination &<br>Customer Benefit<br>Plan |
|---------|------------------------------------|--------------------------|--------------------------------------|--|
| Fitch   | BB+                                | Evolving                 | BB                                   | BBB-   |
| Moody's | Baa3                               | Negative                 | Ba1                                  | Baa3   |
| S&P     | BBB-                               | CreditWatch,<br>Negative | BB+ or BB                            | BBB  |

**V. RESPONSE TO THE DIRECT TESTIMONY OF MR. KEVIN O'DONNELL**

**Q. PLEASE PROVIDE A BRIEF SUMMARY OF MR. O'DONNELL'S DIRECT TESTIMONY AND RECOMMENDATION.**

A. On behalf of the SCEUC, Mr. O'Donnell supports implementation of an 18% reduction in electric rates proposed by ORS. He also suggests that SCANA can activate potential mitigants to SCE&G's credit problems. Specifically, Mr. O'Donnell suggests that SCANA could eliminate its remaining dividend and sell its ownership of Public Service Co. of North Carolina ("PSNC"), to which O'Donnell attributes a potential value of \$2.2 billion. Mr. O'Donnell further asserts that although SCE&G will experience higher costs of long-term debt over time as a consequence of Moody's one-notch downgrade of SCE&G's credit rating from Baa2 to Baa3 on February 5, 2018, that cost is small relative to the savings to customers of the reductions in revenue requirements under the ORS Plan.

**Q. MR. O'DONNELL STATES THAT YOU DID NOT ANTICIPATE DIVIDEND CUTS BUT, INSTEAD, FOCUSED ON THE CONSEQUENCES INVOLVING CREDIT DOWNGRADES AND POSSIBLE BANKRUPTCY.<sup>20</sup> HOW DO YOU RESPOND?**

A. I did not address a dividend cut by SCANA because it cannot be considered as a remedy for SCE&G's ongoing credit problem. Facing the implementation of Act 258, SCANA's decision to reduce its dividend on June 29, 2018 was a

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<sup>20</sup> O'Donnell Direct at 7:11-15.

1 reasonable and prudent decision to enable the parent holding company SCANA to  
2 conserve cash and avoid the insolvency, but dividend cuts will not resolve SCE&G's  
3 credit dilemma relating to weak operating cash flow resulting from the  
4 implementation of the ORS Plan. A utility must have sustainable operating cash  
5 flow and a sound capital structure in order to provide optimal service to customers.

6 **Q. MR. O'DONNELL ASSERTS THAT CUTTING SCANA'S DIVIDEND IS AN**  
7 **EFFECTIVE STEP THAT WILL IMPROVE SCE&G'S CREDIT**  
8 **STABILITY AND A WAY TO "DIG ITS WAY OUT OF A HOLE."<sup>21</sup> DO**  
9 **YOU AGREE?**

10 A. Based on his testimony, Mr. O'Donnell is aware of only one rating  
11 downgrade in 2018: a downgrade by Moody's in February 2018.<sup>22</sup> Mr. O'Donnell  
12 appears to be unaware that two rating agencies (S&P and Fitch) lowered SCE&G's  
13 ratings in August 2018, after the announcement of the 80% dividend cut. Fitch's  
14 downgrade lowered SCE&G's issuer credit rating below investment grade into the  
15 speculative grade category. The two subsequent ratings downgrades on August 8  
16 and 9 were after SCANA's announcement of the dividend cut; both of these rating  
17 agencies noted in their commentaries that the dividend cut by SCANA was helpful  
18 to preserve parent company liquidity, but would not remedy the underlying credit  
19 problem at SCE&G. Contrary to Mr. O'Donnell's assertion, the 80% dividend cut

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<sup>21</sup> O'Donnell Direct at 7: 13-15

<sup>22</sup> O'Donnell Direct at 10: 7-8.

1 did not produce credit stability, so it is foolish to suggest that eliminating a \$70  
2 million per annum dividend would have any greater effect.

3 **Q. HOW DO YOU RESPOND TO MR. O'DONNELL'S TESTIMONY**  
4 **REGARDING THE POSSIBLE SALE OF PSNC AS A MEANS TO**  
5 **MITIGATE THE NEGATIVE CREDIT CONSEQUENCES YOU MENTION**  
6 **IN YOUR TESTIMONY?**<sup>23</sup>

7 A. My response is similar to my response regarding cutting the dividend:  
8 SCANA's sale of PSNC, a sister subsidiary to SCE&G, would not improve the  
9 credit status of SCE&G and would not address the problem of inadequate ongoing  
10 cash flow relative to the operating utility debt. The company that is regulated by the  
11 Commission is SCE&G, and the Commission should determine rates for SCE&G  
12 that are adequate, fair, and reasonable to support the ongoing solvency and financial  
13 strength of the regulated utility company.

14 If Mr. O'Donnell's concern is that SCANA would be unable to issue equity  
15 at the parent company level to fund future required equity investment in SCE&G,  
16 then the sale of a subsidiary would be a potential way to avoid a public issuance of  
17 shares. However, that does not appear to be Mr. O'Donnell's intent. Mr. O'Donnell  
18 appears to suggest that SCANA should subsidize the operations of SCE&G with the  
19 proceeds of the sale of a sister subsidiary, a clear admission that his proposal is  
20 unfair and reasonable to SCE&G and amounts to a taking of SCE&G's property that

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<sup>23</sup> O'Donnell Direct at 9.

1 he suggests be remedied by confiscating \$2.2 billion of other assets of SCANA.  
2 However, the sale of a SCANA subsidiary will not remedy weak operating cash  
3 flow at SCE&G or boost SCE&G's individual credit quality. The rate structure at  
4 SCE&G should be set in a manner that provides the utility company an opportunity  
5 to satisfy future customers' needs for service and attract the capital necessary to do  
6 so.

7 **Q. DOES MR. O'DONNELL RECOMMEND THAT A FURTHER DIVIDEND**  
8 **CUT FOR SCANA WILL SOLVE THE CREDIT PROBLEMS THAT HIS**  
9 **RECOMMENDED REVENUE REDUCTIONS WOULD CREATE AT**  
10 **SCE&G?**

11 A. Mr. O'Donnell is inconsistent regarding cutting the remaining SCANA  
12 common stock dividend. He states that he is "not recommending that SCANA take  
13 that action, but again, that option is available to the Company. Elimination of the  
14 dividend would save SCANA an additional \$70 million per year."<sup>24</sup> But in his  
15 conclusion, he jumps on board with the following assertion:

16 In addition, the sale of PSNC and the entire elimination of the SCANA  
17 dividend can provide even more credit stability to SCANA.<sup>25</sup>

18 In fact, eliminating the dividend entirely is a short-sighted approach that would  
19 impede SCANA and indirectly SCE&G from attracting equity capital in the future.  
20 Some investment accounts are limited by policy or charter from owning stocks that

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<sup>24</sup> O'Donnell Direct at 9:26-10:1.

<sup>25</sup> O'Donnell Direct at 14:8-9.

1 pay no dividends; thus, the costs of such a decision would outweigh the amount of  
2 cash saved, unless the action is necessary to avert bankruptcy.

3 **Q. MR. O'DONNELL ESTIMATES THE COST OF A CREDIT DOWNGRADE**  
4 **TO SCE&G AND ITS CUSTOMERS.<sup>26</sup> DO YOU AGREE WITH HIS**  
5 **ESTIMATES?**

6 A. No, I do not. In fact, the real impact is at least seven to fourteen times greater  
7 than Mr. O'Donnell's estimate. He underestimates the incremental cost in several  
8 ways: (1) arithmetic errors in calculating the amount of new funding; (2) omitting  
9 the principal amount of maturing bonds to be refinanced over the years in question;  
10 (3) estimating a differential interest rate that is considerably lower than the current  
11 market conditions, as illustrated by the August 2018 bond issues; and (4) failing to  
12 consider the incremental interest costs if two more rating agencies lower SCE&G's  
13 issuer credit ratings into the speculative category. I correct these errors and revise  
14 the estimated incremental interest costs as summarized in Table EL-3 below, with  
15 details shown in my Exhibit No. \_\_\_\_ (EL-6).

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<sup>26</sup> O'Donnell Direct at 10:10-12:14.

**Table EL-3**  
**Estimated Incremental Interest Cost Due to Downgrades**

| <b>Revising O'Donnell's Table 1</b>   |                                      |   |  |              |
|---------------------------------------|--------------------------------------|---|--|--------------|
| <b>\$ Millions</b>                    | <b>As in KWO<br/>Table 1 page 12</b> | <b>Current actual<br/>incremental<br/>interest spread</b> | <b>Incremental Interest Cost<br/>Assuming 1- notch downgrades into<br/>Ba, BB, BB categories</b> |              |
| <b>Interest Rate<br/>Differential</b> | <b>16.67 BP</b>                      | <b>55 BP</b>  | <b>75 BP</b>   | <b>95 BP</b> |
| 10 years 2018-2027                    | 12.2                                 | 100.0   | 134.6  | 169.1        |
| 20 years 2018-2037                    | 47.1                                 | 338.5   | 459.8  | 581.0        |
| 30 years 2018-2047                    | 110.3                                | 793.1   | 1,079.8  | 1,366.4      |
| Multiple of KWO<br>estimate           |                                      |   |  |              |
| 10 years                              |                                      | 8.2   | 11.0   | 13.9         |
| 20 years                              |                                      | 7.2   | 9.8  | 12.3         |
| 30 years                              |                                      | 7.2   | 9.8  | 12.4         |

Interest Rate Differential - Incremental cost for SCE&G versus funding cost of the average U.S. electric utility

BP - Basis points.

**Q. WHAT ARE THE ERRORS IN MR. O'DONNELL'S TABLE 1 AND EXHIBIT KWO-1 RELATING TO THE PRINCIPAL AMOUNT OF DEBT ISSUANCE THAT YOU CORRECT IN YOUR EXHIBIT NO. \_\_\_ (EL-5)?**

A. Mr. O'Donnell omitted the funding of transmission investments that he showed in his exhibit KWO-1 when he added the cumulative amount of new debt funding. This error understated the amount of debt issuance by \$344 million but had a far greater effect over time in the cumulative amount of interest cost. In addition to that computational error, he made a conceptual error by omitting the principal amount of bond maturities to be refinanced. That omission contributed to

1 understating the amount of debt issuance by \$4,800 million (\$4.8 billion) over the  
2 time period of his analysis.<sup>27</sup>

3 **Q. WHAT OTHER REVISIONS HAVE YOU MADE IN YOUR TABLE EL-3**  
4 **AND EXHIBIT NO. \_\_\_\_ (EL-5)?**

5 A. Mr. O'Donnell greatly underestimated the cost impact to SCE&G of credit  
6 downgrades by limiting his analysis to a one-notch downgrade made by Moody's  
7 in February 2018 from Baa2 to Baa3 and failing to consider that SCE&G's ratings  
8 over the past 13 months since ORS's Request on September 26, 2017 have declined  
9 by more than one notch. Both S&P and Fitch downgraded SCE&G's credit ratings  
10 by two notches since that date, while Moody's downgraded the rating by one notch.  
11 Furthermore, the credit watch in effect at S&P and Fitch and negative rating outlook  
12 at Moody's cast a further cloud over the ratings by those two agencies, causing a  
13 more negative impact on the debt capital market view of SCE&G's  
14 creditworthiness.

15 Mr. O'Donnell claims to be "conservative" by using generic data rather than  
16 actual market data to estimate a hypothetical impact of a single-notch downgrade  
17 within the three-notch range of A to Baa at 16.67 basis points (that is, 50 basis points  
18 divided by 3). However, we have real data from the bond market; wider yield  
19 spreads on SCE&G's long-term bonds have already far exceeded Mr. O'Donnell's

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<sup>27</sup> My review was limited to the information in O'Donnell's exhibit KWO-1 and did not seek to verify Mr. O'Donnell's basic forecasts of the amount of capital expenditures nor the amount that would be externally financed with debt. Mr. O'Donnell's estimates of those amounts may incorporate other errors that I was not able to audit.

1 estimate. SCE&G actually issued ten-year maturity bonds in August 2018 and  
2 incurred a yield spread that was 50 to 70 basis points higher than that for ten-year  
3 bonds issued by electric utilities whose credit was not similarly burdened (as shown  
4 in Table EL-1). Mr. O'Donnell also fails to consider further adverse movement in  
5 credit spreads if SCE&G experiences further downgrades by S&P or Moody's  
6 below investment grade into speculative grade ratings in the BB and Ba category. If  
7 SCE&G is subjected to a revenue reduction of 18% (as Mr. O'Donnell recommends)  
8 or 20%, the full effect of the ORS Plan, the ratings transition to the BB and Ba  
9 speculative grade category would widen the required yield spread by a greater step  
10 function, probably adding another 25-40 basis points to the current yield spread.

11 Mr. O'Donnell's calculation of a 16.67 basis point increase in interest  
12 expense is misleading. A more accurate depiction of the incremental cost of the  
13 credit downgrades that have already resulted from ORS's Request and Act 258 is  
14 approximately 50 to 60 basis points; in my Table EL-3 above, I estimated the current  
15 cost to SCE&G at 55 basis points higher as a result of its credit downgrades (a  
16 somewhat lower spread than the 63.5 basis point differential noted in Table EL-1.)  
17 Also, if the credit ratings are downgraded below investment grade into the  
18 speculative grade category, the differential spread for SCE&G long-term interest  
19 costs is likely to widen to an aggregate of 75 to 95 points (or more) as shown in  
20 Table EL-3 above.

21 Mr. O'Donnell has further underestimated the costs of credit downgrades to  
22 SCE&G by limiting his table only to incremental costs of debt. Mr. O'Donnell

1 acknowledges that the cost of equity capital will also increase as a result of credit  
2 downgrades,<sup>28</sup> but he omits any calculation of that cost since “setting the cost of  
3 equity is a subjective process seen through many filters.”

4 In summary, Mr. O'Donnell's estimation of the incremental capital cost of  
5 credit downgrades is based on faulty assumptions and computational errors, and he  
6 fails to consider real market data that is readily available. His estimate is unreliable,  
7 and the true cost is substantially in excess of his estimate.

8 **VI. RESPONSE TO THE DIRECT TESTIMONY OF MR. RUBIN**

9 **Q. PLEASE PROVIDE A BRIEF SUMMARY OF MR. RUBIN'S DIRECT**  
10 **TESTIMONY AND RECOMMENDATION.**

11 A. On behalf of AARP, Mr. Rubin asserts that SCE&G's decision to continue  
12 construction of the nuclear units after June 2014 was imprudent. Consequently, he  
13 suggests that investments made after that time, which totaled approximately \$2.5  
14 billion, should be excluded from recovery from customers. He also recommends  
15 that the Commission should order the Company to continue the BLRA surcharge at  
16 the reduced level of the Experimental Rate through December 31, 2018. Under his  
17 proposal, the surcharge would end after that date, and customers would not pay  
18 anything further to support the Project investment. He further recommends that  
19 SCE&G should not be required to refund any amounts previously paid under the

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<sup>28</sup> O'Donnell Direct at 10:13-21.

1 BLRA, thus resulting in customers paying approximately \$2.2 billion to support the  
2 Project.

3 **Q. MR. RUBIN RECOMMENDS THAT THE COMMISSION SHOULD END**  
4 **THE BLRA SURCHARGE ON DECEMBER 31, 2018 AND THAT THERE**  
5 **SHOULD BE NO FURTHER RECOVERY OF NND PROJECT COSTS**  
6 **FROM THE CUSTOMERS. DO YOU AGREE?**

7 A. This is a radical recommendation. It is extremely punitive, and its effect upon  
8 SCE&G's financial health would be staggering. It would have disastrous impact on  
9 SCE&G's ability to sustain itself and meet customers' needs for high quality of  
10 utility service, consequences that Mr. Rubin fails to consider.

11 **Q. HOW DO YOU RESPOND TO MR. RUBIN'S TESTIMONY THAT**  
12 **SCANA'S STOCKHOLDERS CAN ABSORB A \$2 BILLION WRITEDOWN**  
13 **TO COMMON EQUITY?<sup>29</sup>**

14 A. Mr. Rubin appears far more interested in inflicting pain on shareholders of  
15 SCANA than in setting SCE&G on a path toward a financially sound and viable  
16 status. He has lost sight of the fact that SCE&G delivers vital services to its  
17 customers, and putting the utility in a financially distressed condition will not serve  
18 the future needs of customers nor promote a strong economy in South Carolina.

19 Mr. Rubin asserts:

20 If the common equity balance were written down by \$2.0 billion to  
21 \$3.3 billion (as an example) that would result in a common equity

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<sup>29</sup> Rubin Direct at 28-29.

1 ratio of approximately 35%. According to Company witness Lapson,  
2 the Company's debt covenants require at least a 30% equity ratio.<sup>30</sup>  
3

4 Despite Mr. Rubin's dismissive tone, the situation he describes would have grave  
5 consequences. Even if the Company were not forced to default on its debt covenants  
6 by a write-down of the common equity, the impact of a ratio of 35% book equity to  
7 capital would be that SCE&G would be treated as a highly leveraged entity, and its  
8 ratings would most likely be in the speculative grade (below investment grade). As  
9 a result, the Company would be in peril of loss of liquidity and loss of access to  
10 capital markets during a future cyclical downturn in credit financial market  
11 conditions.

12 **VII. RESPONSE REGARDING A POTENTIAL SECURITIZATION**  
13 **TRANSACTION**  
14

15 **Q. SEVERAL WITNESSES, INCLUDING MESSRS. KOLLEN, BINZ, AND**  
16 **VARADARAJAN SUGGEST THAT SCE&G SHOULD FUND THE**  
17 **REGULATORY ASSET REPRESENTING COSTS OF THE NUCLEAR**  
18 **PROJECT THAT ARE APPROVED FOR RECOVERY VIA A**  
19 **SECURITIZATION TRANSACTION. PLEASE BRIEFLY SUMMARIZE**  
20 **MR. KOLLEN'S TESTIMONY ON THIS TOPIC.**

21 **A.** Mr. Kollen proposes a securitization transaction in an amount exceeding \$2.6  
22 billion to fund the recovery of a regulatory asset comprising the portion of the  
23 investment in the Project that ORS proposes for regulatory recovery.<sup>31</sup>

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<sup>30</sup> Rubin Direct at 29:4-9.

<sup>31</sup> Kollen Direct at 10:18-11:19.

1 **Q. PLEASE SUMMARIZE THE DIRECT TESTIMONY AND**  
2 **RECOMMENDATIONS OF CCL AND SACE WITNESSES BINZ AND**  
3 **VARADARAJAN REGARDING A SECURITIZATION TRANSACTION.**

4 A. Mr. Binz suggests that it is feasible to fund the recovery of stranded costs  
5 (such as the allowed portion of the Project cost) at low costs using utility rate  
6 securitization bonds; and second, he proposes the potential use of the proceeds of  
7 the securitization transaction to fund the acquisition by SCE&G of solar or wind-  
8 powered energy production equipment.<sup>32</sup>

9 Mr. Varadarajan testifies regarding six financial scenarios that he modeled  
10 to test the financial aspects of each scenario under three financing assumptions. The  
11 three forms of financing he tested were traditional utility funding regulatory assets  
12 with a mix of debt and equity; an alternative form of corporate bond issuance;<sup>33</sup> and  
13 funding through a special purpose entity using utility securitization bonds. He  
14 compared these financing mechanisms under two assumptions: with or without an  
15 upfront payment to customers. He concludes that the use of securitization bonds  
16 provides the lowest cost financing in several different scenarios. He also suggests  
17 that a combination of securitization bonds and no up-front payment to customers  
18 provides lower costs and a favorable spread of benefits among time periods.<sup>34</sup>

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<sup>32</sup> Binz Direct at 15-22.

<sup>33</sup> Mr. Varadarajan does not provide any evidence or precedents for the alternate type of corporate bonds that make up his second form of financing. I am unaware of any precedents or examples for this funding mechanism, thus suggesting this proposal is a “straw man.”

<sup>34</sup> Varadarajan Direct at 4-22.

1 **Q. WHAT IS YOUR RESPONSE TO THE RECOMMENDATIONS BY THESE**  
2 **THREE WITNESSES REGARDING THE ADVANTAGES OF A**  
3 **SECURITIZATION TRANSACTION?**

4 A. First, the large securitization transaction that the witnesses posit is  
5 inconsistent with the conditions for a merger with Dominion Energy, a business  
6 combination that provides a very viable prospect for SCE&G's future financial  
7 stability and strength. The Dominion Energy business combination along with the  
8 Customer Benefit Plan offer real benefits, and there is no doubt or question about  
9 Dominion Energy's financial capability to carry out the proposed business  
10 combination terms or the other features of the Customer Benefit Plan. I have a high  
11 degree of confidence that the Dominion Energy business combination and Customer  
12 Benefit Plan would result in improved creditworthiness and investment grade credit  
13 ratings for SCE&G.

14 On the other hand, it is not at all clear that securitization is a viable option at  
15 the present time. As I discussed previously, the law does not exist to permit the  
16 supposed securitization transaction and there are numerous legal hurdles to be  
17 cleared before a transaction could take place.

18 **Q. WHAT SORT OF LEGAL HURDLES ARE YOU REFERRING TO?**

19 A. For example, some legal research is essential to determine if a voter  
20 referendum or ballot initiative in South Carolina could invalidate or overturn the  
21 State Pledge, an essential component in a utility tariff securitization. If that  
22 possibility exists, a transaction would not be feasible. None of the witnesses has

1 presented evidence on that point, and indeed, they may not even be aware of this  
2 potential constraint.

3 If that potential problem can be ruled out, then in order to issue bonds in the  
4 financial markets, the form of the enabling law and all related documentation must  
5 conform to a strict financial market standard for utility securitization bonds. The  
6 legislation cannot include any material exceptions that allow customers or classes  
7 of customers to avoid paying the special charges, and there is no leeway for the  
8 legislators to add any bells or flourishes.

9 The Commission would be required to pass through periodic (semi-annual or  
10 annual) adjustments to readjust customer charges in the light of changes in sales  
11 volumes in order to assure that the collections match the debt service requirements  
12 on the bonds. The Commission's review would be limited to checking the accuracy  
13 of the calculations, and intervenors would not have any rights to intervene.

14 Finally, if the Commission's order in this proceeding (the order that gives  
15 rise to the regulatory asset that would be the asset to be securitized) is subject to  
16 judicial appeal because of constitutional challenges or other procedural challenges,  
17 it would be very difficult if at all possible to carry out a securitization transaction in  
18 the principal proposed amount of \$2.6 billion until that challenge has been resolved.

19 **Q. ARE THERE ANY NEGATIVES IN THE SECURITIZATION PROCESS**  
20 **THAT THE OPPOSING WITNESSES HAVE FAILED TO POINT OUT?**

21 **A.** Yes, there are a number of potential negatives. First, a securitization of the  
22 regulatory asset would provide no cash flow to SCE&G, and it would eliminate

1 approximately \$86 million in annual operating cash flow to SCE&G relative to the  
2 ORS Plan absent a securitization transaction. Thus, the transaction would  
3 exacerbate the condition of weak operating cash flows in the event of the  
4 implementation of all the other parts of the ORS Plan.

5 Second, this debt would appear on the balance sheet of SCE&G and would  
6 remain in place for many years, without corresponding equity to balance the capital  
7 structure. Thus, it would burden SCE&G with high balance sheet debt leverage for  
8 one to two decades.

9 Third, the security transaction is an extremely inflexible financial structure  
10 due to its long tenor, large size, and inflexible terms. As such, it would eliminate  
11 some future options both for the policy makers (the legislature and Commission)  
12 and for SCE&G's customers. If new forms of energy or distributed energy become  
13 feasible in the future, the State's Pledge regarding the securitization bond  
14 transaction may prevent state officials or the Commission from embracing such  
15 options. Also, if in the future, electric sales enter a trend of decline due to technology  
16 changes, the Commission would be required to pass through ever greater increases  
17 in the special tariff rate to allocate the debt service revenue requirement to the  
18 remaining sales volume and thus sustain the total level of collections, a process that  
19 could be politically unpopular.

20 **Q. IS THERE AN ASSURED INVESTMENT MARKET FOR THE BONDS**  
21 **THAT WOULD NEED TO BE SOLD IN THIS TRANSACTION?**

1 A. That is not entirely clear. First, debt market participants may not give  
2 credence to the willingness and ability of South Carolina public officials to stick  
3 with the terms of the securitization for a term of up to twenty years in the future if  
4 conditions change, given that the Base Load Review Act passed by the legislature  
5 was set aside eight years after its enactment. Second, if the regulatory asset to be  
6 securitized is created through a litigated proceeding and the securitization  
7 transaction is ordered over the objections of the Company, it might temper  
8 investors' enthusiasm for the transaction. There is no precedent transaction in the  
9 utility sector of a utility tariff securitization that took place over the objections of  
10 the utility company. In fact, in all precedent transactions, the utility company was a  
11 willing and cooperative sponsor of the transaction. If both of these points materialize  
12 as negatives in the investment market, then the yields offered on the bonds would  
13 have to be greater than those estimated by Mr. Kollen in his testimony and relevant  
14 exhibits.

15 **Q. WHAT ARE THE CONDITIONS OR STEPS NECESSARY FOR THE**  
16 **ISSUANCE OF SECURITIZATION BONDS IN THIS CIRCUMSTANCE?**

17 A. This is a brief summary of steps in the process:

- 18 1) As I mentioned already, legal research is needed to assure that there is no  
19 basis under South Carolina law for a change by a subsequent legislative vote,  
20 administrative action, or a voter referendum or ballot initiative in South  
21 Carolina that could invalidate the bonds, interfere with the collection or  
22 adjustments of the rates, or overturn the State Pledge.

1           2) If the results of step 1 are favorable, enabling legislation would be necessary  
2           to permit a securitization transaction; the standards for the form of the statute  
3           and state pledge are very strict.

4           3) The State of South Carolina must pledge not to take any actions that would  
5           interfere with the transaction and recovery of the pledged assets. Terms of  
6           the State Pledge include that the state will not pass laws or regulations or  
7           make any policies that encourage or permit customers to disconnect from the  
8           grid or to avoid paying the special charges as long as any of the transaction  
9           bonds are outstanding.

10          4) The Commission would be required to hold a proceeding to authorize the  
11          issuance of the bonds. In that proceeding, the Commission would also  
12          establish the mechanism for periodically passing through adjustments to the  
13          unit costs through an administrative process to maintain stable collections  
14          and meet the entire revenue requirement of the securitization bonds.

15   **Q.   IS THERE A DOWNSIDE TO THE CONSIDERATION OF A**  
16   **SECURITIZATION TRANSACTION WITHIN THE CONTEXT OF THIS**  
17   **PROCEEDING?**

18   A.       The suggestion that the invested amounts in the Project can be securitized  
19              and thus result in lower costs, at first glance, seems appealing. Given that none of  
20              the necessary conditions have been fulfilled, however, this proposal is simply a  
21              premature and infeasible “red herring” that only serves to distract or divert attention  
22              away from the very real and serious issues that must be considered in this

1 proceeding. A focus of this proceeding must be to reestablish the financial strength  
2 of SCE&G that is entirely necessary for customers to continue to receive safe and  
3 reliable electric services.

#### 4 **VIII. CONCLUSION**

5 **Q. WHAT ARE YOUR OVERALL CONCLUSIONS AND**  
6 **RECOMMENDATIONS?**

7 A. In their Direct Testimony, the witnesses Baudino, Kollen, O'Donnell, and  
8 Rubin recommend steep and punitive reductions in SCE&G's ongoing operating  
9 cash flow without giving adequate consideration to the resulting adverse impacts on  
10 the Company's financial condition and ability to serve customers' future needs.  
11 While customers have an interest in lowering the cost of electricity in the short run,  
12 customers rely on their electric utility for maintaining and extending reliable and  
13 safe service to satisfy not only their current needs but also their future needs. A  
14 financially weak or failing electric utility cannot assure customers a predictable and  
15 high quality of service, which is a necessary foundation for the economic and  
16 employment climate in its service territory. The Customer Benefit Plan and the  
17 proposed Dominion Energy business combination provide a strong prospect of  
18 restoring SCE&G's creditworthiness while also providing benefits to current and  
19 future customers. On the other hand, the ORS Plan and proposals by Rubin and  
20 O'Donnell are likely to drive SCE&G's issuer credit into the sub-investment grade  
21 (speculative grade), with attendant risk of losing access to capital during cyclical  
22 periods of constrained financial markets.

1           Proposals for the securitization of any regulatory assets that result from the  
2           decision reached as a result of this proceeding are not germane to this proceeding.  
3           A separate regulatory process would be devoted to consideration and authorization  
4           of a securitization transaction, if in fact such a transaction becomes feasible at some  
5           time in the future. At present, it is a distraction from the need to determine the  
6           financial future of SCE&G on a healthy and sustainable basis.

7   **Q.   DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

8   **A.           Yes, it does.**